Supreme Court, U.S.
FILED
AUG 26 1998
OFFICE OF THE CLERK

No. 98-174

In The

Supreme Court of the United States

October Term, 1997

DAVID W. SILVERMAN, as Independent Fiduciary of The Unitron Graphics, Inc. Profit Sharing Trust and Unitron Graphics, Inc. Profit Sharing Trust-Union and Non-Union Division,

Petitioner,

vs.

MUTUAL BENEFIT LIFE INSURANCE COMPANY, PRINCIPAL MUTUAL LIFE INSURANCE COMPANY and HELENE GORNY,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF IN OPPOSITION FOR RESPONDENT PRINCIPAL MUTUAL LIFE INSURANCE COMPANY

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COUNTERSTATEMENT OF QUESTION PRESENTED[1]

Whether the Second Circuit Court of Appeals properly affirmed the district court's dismissal of Petitioner's claim against Principal for breach of co-fiduciary obligations under § 405(a) of the Employee Retirement Income Security Act of 1974, as amended, 29 U.S.C. § 1105(a) (1994) ("ERISA").

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1. This brief in opposition addresses only those portions of Petitioner, David W. Silverman, as Independent Fiduciary of The Unitron Graphics, Inc. Profit Sharing Trust and Unitron Graphics, Inc. Profit Sharing Trust-Union and Non-Union Division ("Petitioner" or "Silverman")'s Petition for Writ of Certiorari that relate to Respondent Principal Mutual Life Insurance Company ("Principal").

PARTIES TO THE PROCEEDING

The petition correctly names the parties to the proceeding, but incorrectly states that Principal, Mutual Benefit Life Insurance Company ("Mutual Benefit"), and Helene Gorny ("Gorny") were defendants-appellants. Defendants were appellees in the Second Circuit Court of Appeals.

STATEMENT PURSUANT TO RULE 29.6

Principal Mutual Life Insurance Company ("Principal") states that it was reorganized effective July 1, 1998. Principal Mutual Holding Company now wholly owns Principal Life Insurance Company. Principal Life Insurance Company has no corporate parents or nonwholly owned subsidiaries that have issued shares to the public other than:

United Payors & United Providers, Inc.
Sloans Lake Management Corp.

Principal has also organized the following Mutual Funds:

Principal Aggressive Growth Fund, Inc.
Principal Asset Allocation Fund, Inc.
Princor Balanced Fund, Inc.
Principal Balanced Fund, Inc.
Princor Blue Chip Fund, Inc.
Princor Bond Fund, Inc.
Principal Bond Fund, Inc.
Princor Capital Accumulation Fund, Inc.
Principal Capital Accumulation Fund, Inc.
Princor Cash Management Fund, Inc.
Principal Money Market Fund, Inc.
Princor Emerging Growth Fund, Inc.
Principal Emerging Growth Fund, Inc.

Princor Government Securities Income Fund, Inc.
Principal Government Securities Fund, Inc.
Princor Growth Fund, Inc.
Principal Growth Fund, Inc.
Princor High Yield Fund, Inc.
Principal High Yield Fund, Inc.
Princor Tax-Exempt Bond Fund, Inc.
Princor Tax-Exempt Cash Management Fund, Inc.
Princor Utilities Fund, Inc.
Princor World Fund, Inc.
Principal World Fund, Inc.
Principal Special Markets Fund, Inc.

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APPENDIX

Appendix A — Relevant Statutes Involved 1a

PERTINENT STATUTORY PROVISIONS

The statutory provisions involved with respect to Petitioner's claim against Principal are 29 U.S.C. § 1105(a) (1994), 29 U.S.C. § 1109 (1994) and 29 U.S.C. § 1132(a) (1994 & Supp. II 1996). These statutes have been set forth in full in the Appendix hereto.

COUNTERSTATEMENT OF THE CASE

On August 30, 1991, Mutual Benefit, the first investment manager of the Unitron Graphics, Inc. Profit Sharing Trust-Union and Non-Union Divisions (the "401(k) plans"), released $239,811.28 of the 401(k) plans' assets to Jacob Zucker and Aaron Fertig, the plans' named trustees and fiduciaries (A-5a-6a).[2] Immediately upon their receipt in September 1991 of the 401(k) plans' assets, Zucker and Fertig embezzled $130,000 (A-6a). The funds were embezzled before Principal, who was to take over administration and investment of the 401(k) plans, received the remaining $109,811.28 from Unitron Graphics (A-6a). Although Principal sent letters to Zucker and Fertig demanding that the remaining $130,000 released by Mutual Benefit be accounted for, its efforts were to no avail. Within six months, Unitron Graphics had filed for bankruptcy and the United States Department of Labor was investigating Zucker's and Fertig's actions (A-7a-8a). Eventually, Zucker and Fertig were indicted and pled guilty. As part of their sentence, they were ordered to pay restitution to the 401(k) plans (A-8a). However, "Zucker and Fertig proved to be insolvent" (A-8a).

Petitioner, who was appointed by the court in the criminal action to effectuate payment of restitution, commenced this action against Mutual Benefit, its employee Gorny and

2. References to the Appendix to the Petition for Writ of Certiorari are cited as A-__ .

Principal. Petitioner charged that Mutual Benefit and Gorny breached their fiduciary duties by improperly transferring $239,811.28 of the 401(k) plans' assets to Zucker and Fertig and that Principal breached its co-fiduciary obligations by allegedly failing to take appropriate action when it received, on October 8, 1991, only $109,811.28 of the $239,811.28 released by Mutual Benefit (A-9a). The district court granted summary judgment to Principal and the Second Circuit affirmed.

With respect to Principal, the issue on this Petition for Writ of Certiorari is whether this Court should review the Second Circuit Court of Appeals' ruling that, to recover damages for breach of co-fiduciary obligations under 29 U.S.C. § 1105(a), Petitioner had the burden of proving that Principal's alleged breach resulted in a loss to the 401(k) plans. Review is not warranted for a number of reasons. Contrary to Petitioner's assertion, the Second Circuit's decision does not subvert the goals of ERISA by granting investment managers unwarranted broad protection from liability for their improper conduct (Petition for Writ of Certiorari ("Pet.") at 4). The Second Circuit did nothing more than apply the plain language of sections 405(a) and 409(a) of ERISA and well-settled case law in determining that, where compensatory damages are sought, the plaintiff bears the burden of proving that the plan's losses resulted from the defendant's breach of co-fiduciary obligations.

There is no conflict between the Second Circuit and other circuits on this point. To the contrary, courts have uniformly held that, to recover monetary damages, a plaintiff must prove that a breach of fiduciary or co-fiduciary duty resulted in a loss to the ERISA plan. The authorities relied upon by Petitioner merely stand for the unremarkable proposition that once the plaintiff has met its burden of showing that the breach of

fiduciary duty at issue resulted in a plan loss, the burden of contradicting that showing or presenting another defense shifts to the defendant.

The Second Circuit found that Petitioner did not meet his threshold burden of demonstrating a causal connection between Principal's alleged breach of co-fiduciary obligations and the 401(k) plans' loss. Since Petitioner declined to show *any* connection between the alleged breach and the loss, the Second Circuit never even reached the issue of shifting the burden to Principal to disprove damages or otherwise present another defense. Indeed, in the courts below, Petitioner repeatedly argued for imposition of strict liability and that causation was not an element of a claim for breach of co-fiduciary obligations. Petitioner's current attempt to urge this Court to adopt a standard that would excuse a plaintiff from coming forward with any evidence on one of the elements of its claim — a causal connection between the defendant's conduct and the loss to the plan — conflicts with the plain language of the statute, finds no basis in the case law and should be rejected.

Further, this action presents a unique factual situation that does not warrant review. To the extent that any authorities can be construed to place the burden on a fiduciary to disprove causation, those cases involved direct actions against the fiduciaries who engaged in self-dealing, prohibited transactions or active misconduct, which rendered it impossible to calculate damages after liability was established. There are no such facts in this case. To excuse Petitioner from establishing an element of his *prima facie* case under the facts presented here not only finds no support in the law, but it would also greatly expand the burdens placed on investment advisers, essentially rendering them insurers for conduct of the named trustees and fiduciaries of a plan.

A. The 401(k) Plans' Contract with Mutual Benefit and Mutual Benefit's Transfer of $239,811.28 in Plan Assets to Zucker and Fertig

The 401(k) plans were established by Unitron Graphics in July 1988, pursuant to section 401(k) of the Internal Revenue Code, for the purpose of providing retirement benefits to both the union and non-union employees of Unitron Graphics. Jacob Zucker and Aaron Fertig were the named fiduciaries and trustees of those plans as well as officers of Unitron Graphics (A-4a-5a). When the plans were first established, "[t]he plan's assets were invested pursuant to a group annuity contract between the trustees and Mutual Benefit" (A-5a). However, in mid-1991, when Mutual Benefit was experiencing well publicized financial problems, the trustees terminated the 401(k) plans' relationship with Mutual Benefit and, in early July 1991, contracted with Principal to act as investment manager (A-5a-6a).

On August 30, 1991, Mutual Benefit issued to Zucker a check in the amount of $239,811.28 payable to the 401(k) plans (A-6a). Principal had no contact with Mutual Benefit regarding the transfer of the 401(k) plan monies held by it (JA-431, ¶ 10).[3] Accordingly, Principal did not know how much money Mutual Benefit had released until Principal received a letter dated September 17, 1991 from Howard Lowett at Unitron Graphics (A-6a).

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3. References to the Joint Appendix before the Second Circuit Court of Appeals are cited as JA-__.

B. Zucker's and Fertig's Embezzlement of $130,000 from the 401(k) Plans' Account Prior to Transfer of Any Monies to Principal

As Petitioner readily concedes, Zucker and Fertig embezzled $130,000 from the 401(k) plans' bank account before the remaining $109,811.28 released by Mutual Benefit was forwarded to Principal on October 8, 1991 to invest under the newly executed Group Annuity Contracts (A-6a).[4] The $130,000 embezzled by Zucker and Fertig was never returned by them to the 401(k) plans' account or forwarded to Principal but, as the Petitioner himself recognized, was appropriated by Zucker and Fertig for their own use (JA-15, ¶ 2). According to the sentencing memoranda submitted by Zucker and Fertig in their criminal action, they immediately used the embezzled monies in an unsuccessful effort to keep Unitron Graphics in business (JA-354, ¶ 10; 397-99, 403-08, 414-18). Having failed, Unitron Graphics filed for bankruptcy in early January 1992 (A-7a; JA-739-43).

C. Principal's Letters to Zucker and Fertig

Unaware that Zucker and Fertig had already embezzled and spent $130,000, by letter dated November 5, 1991, Principal informed Zucker and Fertig that, from "what limited recordkeeping data we have, only a portion of [the 401(k) plans'] assets" had been received (A-6a; JA-432, ¶ 14; 682). Principal further informed them that the "balance of these assets must be accounted for," and that, if Principal was to be the

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4. Principal held and invested the $109,811.28 it received in accordance with the terms of the Group Annuity Contracts (JA-431-32, ¶ 12). Today, that money either remains invested with Principal or was distributed at the request of participants in the 401(k) plans (JA-432, ¶ 12). Petitioner does not allege that Principal engaged in any improper conduct whatsoever with respect to the plan monies it held.

only investment manager, the balance of these funds should be forwarded immediately (A-6a, JA-682).

Having received no response to its November 5, 1991 letter, Principal again wrote to Zucker and Fertig on January 28, 1992, demanding that the trustees either transfer the remaining $130,000 to Principal or account for the balance of the plan assets (A-7a; JA-641-42, ¶ 3; 690-92). A few days later, a representative of Unitron Graphics advised Principal that Unitron had filed for bankruptcy and requested that Principal delay notifying the Department of Labor about the 401(k) plans' delinquency in forwarding employee deferral amounts until a buyer could be found for the business.[5] Principal refused to agree to this request (A-7a; JA-642, ¶ 5; 695).

On March 30, 1992, Principal was contacted by the Department of Labor, which was already investigating the trustees' actions regarding the 401(k) plans (JA-643, ¶ 6). Principal fully cooperated with the Department of Labor (A-8a).

D. The Department of Labor's Investigation and Subsequent Indictment of Zucker and Fertig

Although the Department of Labor began investigating Zucker and Fertig by March of 1992, it was unable to recover the already embezzled monies in the course of its investigation (A-8a).

Zucker and Fertig were subsequently indicted and pled guilty to conspiracy to embezzle funds (A-8a). Although

5. The January 28, 1992 letter also addressed Zucker's and Fertig's failure to forward new employee salary contributions to Principal in a timely fashion and demanded that these monies be forwarded within five business days (JA-690). The employee salary deferrals are not at issue in this action.

ordered to pay restitution, Zucker and Fertig were insolvent. The partial payments they later made came from loans and donations from family and friends (A-8a). The bankrupt Unitron Graphics did not have any assets with which to reimburse the 401(k) plans (A-65a; JA-761-63).

E. The Petitioner's Lack of Investigation or Evidence That Any of the Embezzled Monies Could Be Recovered

Notwithstanding discovery, his access to the Department of Labor's investigatory materials and the United States Attorney's grand jury materials, Petitioner came forward with absolutely no evidence that the $130,000 could have been recovered by any party, including Principal. Rather, as the Second Circuit noted,

> Silverman expressly declined to proffer evidence as to what Fertig and Zucker did with the funds they embezzled, or as to whether at any pertinent time they had assets that could have made good the loss. Silverman . . . evidently recognize[d] that there is no record evidence to demonstrate a causative link between Principal's inaction and the plan's loss.

(A-16a). Instead, Petitioner maintained, and still maintains, that causation simply is not an element of a claim for breach of co-fiduciary obligations, and that Principal is strictly liable for the loss caused to the 401(k) plans by Zucker's and Fertig's embezzlement (Pet. at 22).

F. The Decisions Below

By Opinion and Order dated May 16, 1996, the district court granted Principal's motion for summary judgment and denied plaintiff's cross-motion. *Silverman v. Mutual Benefit*

Life Ins. Co., No. 95-CV-0500 (ARR) (E.D.N.Y. May 16, 1996) (A-38a-67a). First, the district court found Petitioner's claim under § 405(a)(1) "unpersuasive", since there was no evidence to support his contention that Principal attempted to conceal what little it knew about Zucker's and Fertig's actions (A-55a-58a).[6] Second, the district court concluded that Petitioner could not "recover under § 405(a)(2), because Principal's conduct did not enable the trustees [Zucker and Fertig] to commit a breach [of their fiduciary duties]" (A-59a). Third, although it found that there were genuine issues of material fact as to whether Principal had sufficient knowledge of Zucker's and Fertig's breach of fiduciary duty to "trigger its duty under § 405(a)(3) to make reasonable efforts to remedy the breach," the district court concluded that "reasonable efforts could not have remedied the breach" (A-61a; 63a). Accordingly, the district court determined that Principal cannot be held liable since "the court cannot conclude that Principal's conduct caused a loss" (A-66a).

In affirming the district court, the Second Circuit summarily dismissed, as without merit, Petitioner's claims under §§ 405(a)(1) and (2) (A-15a). With respect to Petitioner's claim under § 405(a)(3), the Second Circuit ruled that

> [I]n order to satisfy the necessary element imposed by §§ 1105(a)(3) and 1109(a), Silverman must show that (i) Principal had knowledge of the

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6. The Petitioner argues at length that Principal breached its fiduciary duties by concealing information from a 401(k) plan participant (Pet. at 13-14, 21). As the district court expressly found, Principal did not conceal any information from or otherwise mislead participants (*See* discussion at A-56a-58a). The Second Circuit agreed (A-15a). Regardless, Petitioner's false accusation that Principal "purposefully secret[ed] the embezzlement" is irrelevant to whether this Court should review the Second Circuit's decision that the Petitioner had the burden of proving that the 401(k) plans' loss resulted from Principal's alleged breach of co-fiduciary duty.

> trustees' embezzlement, (ii) Principal failed to make reasonable efforts to remedy the trustees' breach and (iii) the fund's loss resulted from that failure.

(A-14a).

The Second Circuit held that Petitioner had the burden of "demonstrat[ing] in a suit for compensatory damages that the plan's losses 'result[ed] from Principal's breach of § 1105(a)(3)' " (A-13a). Because Petitioner failed to come forward with any evidence demonstrating that the plans' loss resulted from Principal's alleged inaction, as opposed to Zucker's and Fertig's embezzlement, the Second Circuit affirmed the district court's dismissal of the § 405(a)(3) claim.[7]

REASONS FOR DENYING THE WRIT

I.

THE SECOND CIRCUIT CORRECTLY APPLIED THE CLEAR STATUTORY LANGUAGE OF ERISA AND SETTLED CASE LAW

The Second Circuit properly applied the plain language of ERISA and settled law in ruling that Petitioner had the burden of proving that the 401(k) plans' losses resulted from Principal's alleged breach of co-fiduciary duty. 29 U.S.C. § 1105(a) provides:

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7. The Second Circuit did not hold that Petitioner had satisfied the first two elements under § 405(a)(3), but rather that Petitioner had adduced sufficient evidence to present a jury question on whether Principal had knowledge of Zucker's and Fertig's breach but had failed to make reasonable efforts to remedy it (A-14a). The dissenting judge was of the further view that the evidence of causation was sufficient to give rise to a material issue of fact to present to a jury, though he, too, rejected Petitioner's effort to read the causation requirement out of § 409(a) (A-15a).

> [A] fiduciary with respect to a plan shall be liable for a breach of fiduciary responsibility of another fiduciary with respect to the same plan in the following circumstances:
>
> * * *
>
> (3) if he has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach.

In the courts below, Petitioner argued, without citing any relevant authorities, that causation is not an element of a claim for breach of co-fiduciary obligations and that § 405(a) is essentially a "no-fault" statute.[8] Rejecting this position, the Second Circuit stated: "Like the district court, we read the relevant statutes to require Silverman to show that the loss claimed resulted from Principal's breach" (A-12a).

In recognizing the causation requirement, the lower courts looked to ERISA's exclusive civil enforcement scheme, 29 U.S.C. § 1132(a), which expressly limits the types of actions that fiduciaries can commence under ERISA when they seek recovery of compensatory damages.[9] Finding that 29 U.S.C. § 1132(a)(2)[10] was the only provision that could provide a basis

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8. Petitioner maintains that position before this Court, arguing that "29 U.S.C. § 1105 contains no 'but for' analysis" (Pet. at 22).

9. Indeed, this Court has repeatedly made clear that ERISA's carefully integrated and exclusive civil enforcement scheme, 29 U.S.C. § 1132(a), provides " 'strong evidence that Congress did *not* intend to authorize other remedies that it simply forgot to incorporate expressly.' " *Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133, 144 (1990) (quoting *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 54 (1987)).

10. 29 U.S.C. § 1132(a) provides:

(Cont'd)

for the exercise of jurisdiction over Petitioner's claims for compensatory damages, the lower courts concluded that Petitioner must be seeking relief for violation of 29 U.S.C. § 1109 (A-12a; 50a).

29 U.S.C. § 1109(a), in turn, expressly requires a causal connection between the alleged breach of a duty imposed upon a fiduciary and the loss to the plan by providing that

> [a]ny person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this subchapter shall be personally liable to make good to such plan any *losses to the plan resulting from each such breach.*

(Emphasis added) (A-13a). Accordingly, the lower courts rejected Petitioner's contention that liability for breach of co-fiduciary obligations could be imposed in the absence of a causal connection between Principal's alleged breach and the 401(k) plans' loss (A-12a-13a). As the Second Circuit explained:

> Jurisdiction for this suit for compensatory damages arises under § 1132(a)(2), which permits a fiduciary to bring a civil action "for appropriate relief under section 1109 of this title". . . . This statute therefore

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(Cont'd)

> Persons empowered to bring a civil action
>
> A civil action may be brought —
>
> . . .
>
> (2) by the Secretary [of Labor], or by a participant, beneficiary or fiduciary for appropriate relief under section 1109 of this title.

> requires a plaintiff to demonstrate in a suit for compensatory damages that the plan's losses "result[ed] from" Principal's breach of § 1105(a)(3). . . . Specifically, Silverman must show some causal link between the alleged breach of Principal's duties and the loss plaintiff seeks to recover. . . . This principle is consistent with the common law of trusts, which imposes a duty on a successor trustee to remedy the breach of a prior trustee, and imposes liability for breach of this duty "to the extent to which a loss results from [the successor trustee's] failure to take such [remedial] steps."

(A-12a-14a).

The cases are uniformly in agreement. *See Kuper v. Quantum Chemicals Corp.*, 852 F. Supp. 1389, 1396 (S.D. Ohio 1994) (" '[P]roof of a causal connection . . . is required between a breach of fiduciary duty and the loss alleged.' ") (quoting *Diduck v. Kaszycki & Sons Contractors, Inc.*, 974 F.2d 270, 279 (2d Cir. 1992)), *aff'd sub nom. Kuper v. Iovenko*, 66 F.3d 1447 (6th Cir. 1995); *Friend v. Sanwa Bank California*, 35 F.3d 466, 469 (9th Cir. 1994) (granting defendant's motion for summary judgment on the grounds that even if Sanwa had violated its fiduciary duties, the plaintiff has not presented an issue of material fact that the breach caused the losses to the plan); *Diduck*, 974 F.2d at 279 (ruling that plaintiff could not recover for breach of co-fiduciary obligations without showing that absent the breaches the monies would have been recovered); *Willett v. Blue Cross and Blue Shield*, 953 F.2d 1335, 1343 (11th Cir. 1992) (agreeing with Blue Cross' argument that causation was an element of a claim for breach of co-fiduciary duties); *Whitfield v. Lindemann*, 853 F.2d 1298, 1304 (5th Cir. 1988) (requiring a causal connection between

the breach of fiduciary duty and the loss to the plan); *Hecht v. Colorboard Packaging Corp.*, 856 F. Supp. 184, 190 (S.D.N.Y. 1994) (dismissing plaintiffs' claims for breach of fiduciary duty under ERISA on the grounds that they failed "to prove the necessary connection between the trustee's breach of fiduciary duty and actual losses incurred by the pension plan"); *Brink v. DaLesio*, 496 F. Supp. 1350, 1383 (D. Md. 1980) (ruling that imposition of liability for breach of co-fiduciary duties required proof of a causal connection between the co-fiduciary's conduct and the loss to the plan), *aff'd in part and rev'd in part on other grounds*, 667 F.2d 420 (4th Cir. 1981).

Since causation is an element of Petitioner's *prima facie* case, the Second Circuit applied the general rule that "plaintiff bears the burden of proving it" (A-16a).

> Congress has placed the burden of proving causation on the *plaintiff* by requiring him to prove that the losses "result[ed] from" the defendant's inaction. *See* 29 U.S.C. §§ 1109(a), 1105(a)(3).

(A-17a). There is nothing remarkable about this decision warranting review by this Court. In fact, the Second Circuit's decision applied centuries-old principles embedded in the common law of trusts. *See, e.g.*, George G. Bogert & George T. Bogert, *The Law of Trusts and Trustees* § 871 (2d ed. rev. 1995) ("If [the beneficiary] seeks damages, a part of his burden will be proof that the breach caused him a loss. . . . If the beneficiary makes a prima facie case, the burden of contradicting it or showing a defense will shift to the trustee.").

And, ERISA cases involving breach of co-fiduciary obligations have consistently placed the burden of proving causation on the plaintiff. For example, the Eleventh Circuit in *Willett v. Blue Cross and Blue Shield*, 953 F.2d 1335 (11th Cir.

1992), addressed, among other things, whether Blue Cross breached its co-fiduciary obligations under 29 U.S.C. § 1105(a)(3). With respect to the burden of proof, the court ruled that

> the burden of proof on the issue of causation will rest on the beneficiaries; they must establish that their claimed losses were proximately caused . . . by a failure by Blue Cross to cure May's breach.

Id. at 1343. *See Diduck*, 974 F.2d at 279 (placing the "burden of proving an amount of damages caused by the fraud" on the plaintiff); *Pension Fund-Mid Jersey Trucking Industry — Local 701 v. Omni Funding Group*, 731 F. Supp. 161, 176 (D.N.J. 1990) (rejecting plaintiff's claim that defendant breached its co-fiduciary obligations under ERISA, reasoning that "[p]laintiff has not shown any causal relationship between Southeast Bank's fiduciary duty concerning short term investments and the alleged fraudulent conduct surrounding the mortgage loans"). *See Salovarra v. Eckert*, No. 94 Civ. 3430, 1998 U.S. Dist. LEXIS 7992, at *11 (S.D.N.Y. May 26, 1998) (stating "that plaintiff's demonstration of a breach of fiduciary duty alone is not sufficient to shift the burden to defendant to disprove loss").

Here, Petitioner failed to satisfy his burden of establishing that the plans suffered a loss resulting from Principal's alleged breach of co-fiduciary duty. He merely relied on Zucker's and Fertig's embezzlement. If that were all that was needed, Petitioner could satisfy his burden of establishing a *prima facie* case simply by referring to the loss *caused by Zucker and Fertig*, without coming forward with a shred of evidence in support of the essential element of his claim *against Principal* — a causal connection between Principal's alleged failure to take reasonable steps to remedy Zucker's and Fertig's breach and the 401(k) plans' failure to recover the embezzled monies. Section 409

imposes liability for losses *resulting* from a breach, not losses *related* to a breach. Thus, the Second Circuit followed settled precedent and the plain language of ERISA in holding that Petitioner had failed to come forward with evidence that Zucker and Fertig had assets that Principal could have recovered at the time of Principal's alleged breach. As the Second Circuit found, "Silverman has come forward with no evidence bearing on when the money vanished," but instead

> expressly declined to proffer evidence as to what Fertig and Zucker did with the funds they embezzled, or as to whether at any pertinent time they had assets that could have made good the loss.

(A-19a; A-16a).

II.

THERE IS NO CONFLICT AMONG THE CIRCUITS

The Eighth Circuit's opinion in *Herman v. Mercantile Bank, N.A.*, 137 F.3d 584 (8th Cir. 1998), upon which Petitioner relies, is not in conflict with the Second Circuit's decision. In *Herman*, the Department of Labor commenced an action alleging, *inter alia*, that Timothy J. Schwent ("Schwent"), the fiduciary for a corporate health plan, breached his fiduciary duties by failing to commence an action against the corporation when it failed to pay health claims. The Eighth Circuit held that Schwent was not liable for breach of fiduciary duties because the decision not to commence an action was prudent. *Id.* at 588. Thus, the ruling in *Herman* turned upon whether the defendant had breached his fiduciary duties, not, as here, on whether a breach of co-fiduciary duty resulted in the plans' loss.

In any event, *Herman*'s discussion of plaintiff's burden is fully consistent with this case.

> We conclude that in order to prove a breach of fiduciary duty for failure to pursue any lawsuit, the Secretary must prove a lawsuit would be successful and advantage the beneficiaries of the plan. If a fiduciary won a judgment in a lawsuit against an employer but remained unable to collect on that judgment, the lawsuit would waste the resources of both the plan and the employer. *Therefore, in this case the Secretary needed to prove that if Schwent pursued a lawsuit, the health plan would have benefitted.*

Id. at 587 (emphasis added). *See id.* at 588 ("[T]he Secretary needed to prove that such suit would have succeeded and benefitted the plan participants."). The Eighth Circuit found that bringing a lawsuit would not have been prudent because "the health plan would not have won a collectable judgment." *Id.* at 587. Like the Second Circuit, the Eighth Circuit took the position that the plaintiff had the burden of proving that, had the defendant fiduciary taken action, the plan would have benefitted by recovering additional monies.

In attempting to manufacture a conflict where none exists, Petitioner relies heavily on the last paragraph before the conclusion of *Herman*, which was modified in response to the Department of Labor's request for clarification. That paragraph states, in part,

> Schwent might have presented a valid defense by meeting his burden of proving that no benefit would accrue to the plan by a successful lawsuit against [the corporation] because of [the corporation's] greatly impaired financial condition.

Id. at 588. This statement does not demonstrate a conflict, but merely reaffirms the rule in *Martin v. Feilen*, 965 F.2d 660 (8th Cir. 1992), that once the plaintiff has established that the defendant's breach of fiduciary duty caused the plan to suffer a loss, the burden shifts to the defendant to contradict plaintiff's showing or establish a defense. Indeed, in clarifying its decision, the Eighth Circuit not only reaffirmed that it was the Secretary's burden to prove that a lawsuit would have benefitted the plan participants, but it also rejected the Secretary's invitation to distinguish its decision from *Silverman* or even note any disagreement with the Second Circuit's decision (*Cf.* Pet. at 25).

And, as the Second Circuit found, *Martin* is fully consistent with this case. *Martin* involved *calculation of damages* after plaintiff proved a loss to the plan resulting from the defendant's breach of fiduciary duty, not whether the plaintiff had satisfied its threshold burden of showing that the breach caused a loss. The Second Circuit explained:

> the issue in Martin involved the calculation of damages after the plaintiff proved a prima facie case that the plan suffered a loss resulting from the defendant's breach of its fiduciary duty. See *id.* (holding that Secretary of Labor had established a prima facie case by proving that defendants "violated § 1104 by causing the ESOP to engage in stock transactions that caused specific injury to the ESOP at the time in question."

(A-17a) (emphasis in original).

Petitioner also errs in arguing that the Second Circuit's approach is somehow at variance with *Kemmerer v. ICI Americas Inc.*, 70 F.3d 281 (3d Cir. 1995) (Pet. at 27). There, the Third

Circuit rejected the "appellants' contention that the burden [of proof] should shift simply because this is an ERISA case." *Id.* at 290. Reaching this conclusion, the court explained:

> To be sure, in certain ERISA cases, courts have placed the burden of proof on the trustee of the plan. But those cases involved first, the trustee's breach of fiduciary duty, and second, a definite loss. . . . Neither of the prerequisites to burden-shifting is present here.

Id.

Nor does *Roth v. Sawyer-Cleator Lumber Co.*, 16 F.3d 915 (8th Cir. 1994), help Petitioner in creating a conflict where none exists. The Eighth Circuit there reversed the district court's grant of summary judgment to the defendant fiduciaries, finding that there were questions of fact concerning whether the fiduciaries' investment decisions were prudent. In discussing the plaintiffs' burden, the court again simply reiterated the rule in *Martin v. Feilen*, 965 F.2d 660 (8th Cir. 1992), which is not in conflict with the Second Circuit's decision here.

McDonald v. Provident Indemnity Life Insurance Co., 60 F.3d 234 (5th Cir. 1995), is also consistent with the case at bar. In *McDonald*, the court ruled that recovery was barred because the failure of a fiduciary to inform an employer of a schedule for re-rating premiums did not result in a loss to the plan, but only to the individual plan participant who was bringing suit. In passing, the court stated that the plaintiff has the burden of proving a breach of fiduciary duty and a loss to the plan. *Id.* at 237.

In short, just as the Eleventh Circuit in *Willett*, the Second Circuit correctly placed the burden on Petitioner to demonstrate

that Principal's alleged breach of co-fiduciary duty caused a loss to the 401(k) plans. That decision is not in conflict with the decisions of other circuit courts, and not a single court has suggested there is any such conflict. Rather, the Second Circuit's decision simply applies the basic rule that the plaintiff has the burden of proof with respect to the elements of his claim for relief.

III.

MOREOVER, THIS ACTION INVOLVES A UNIQUE SET OF FACTS INVOLVING AN ALLEGED BREACH OF CO-FIDUCIARY DUTY AND IS NOT AN APPROPRIATE CASE FOR ADOPTING A BROAD RULE OF LAW SHIFTING THE BURDEN OF PROOF TO INVESTMENT MANAGERS

This action involves an alleged breach of co-fiduciary, not fiduciary, obligations. There are no allegations that Principal engaged in any self-dealing, prohibited transactions or commingling of funds, or that it received any benefit as a result of Zucker's and Fertig's embezzlement. Further, Principal did not actively participate in their breach or otherwise create obstacles to Petitioner's ability to prove that Principal's alleged action or inaction — as opposed to Zucker's and Fertig's actions — caused a loss to the 401(k) plans. Indeed, if there were any evidence that Principal could have remedied the 401(k) plans' loss, which there is not, Petitioner could easily have obtained that evidence from the Department of Labor, the United States Attorney or through discovery or investigation of Zucker's, Fertig's and Unitron Graphic's financial condition.

To the extent that existing authorities can be read to impose a burden on a defendant fiduciary to disprove causation, those cases involved factual situations vastly different from that

presented here. First, none involves alleged breaches of co-fiduciary, as opposed to fiduciary, duties. Second, the fiduciary duty cases shifting the burden involve (a) calculating damages after liability has been established or (b) a fiduciary's commingling of funds, self-dealing, active misconduct or creation of obstacles to the plaintiff's ability to prove the amount of damages. *See The New York State Teamsters Council Health and Hosp. Fund v. Estate of DePerno*, 18 F.3d 179 (2d Cir. 1994) (shifting the burden to defendant to prove damages in an action involving prohibited transactions)[11]; *Leigh v. Engle*, 727 F.2d 113, 138-39 (7th Cir. 1984) (imposing the burden of proving the amount of damages on the defendants, where defendants have "made it difficult to disentangle commingled profits"); *Donovan v. Bierwirth*, 754 F.2d 1049, 1052 (2d Cir. 1985) (placing burden of proving damages on defendants, whose active misconduct in breaching their fiduciary duties made it difficult, if not impossible, for plaintiffs to prove their damages); *Martin v. Feilen*, 965 F.2d 660 (8th Cir. 1992) (shifting the burden for purposes of calculating damages only after the plaintiff established that the defendants' self-dealing and conflict of interest caused a loss to the plan); *Ned v. United Mine Workers of America*, 556 F.2d 190, 210 (3d Cir. 1977) (shifting the burden to prove, as a matter of defense, that the loss would have occurred in the absence of a breach only *after* plaintiffs proved that they suffered a loss as a result of defendants' breach of their fiduciary duties).[12]

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11. In *Salovarra v. Eckert*, No. 94 Civ. 3430, 1998 U.S. Dist. LEXIS 7992 (S.D.N.Y. May 26, 1998), the district court found that *DePerno* did not support finding that once the plaintiff demonstrated a breach of fiduciary duty, the burden shifted to the defendant to disprove a loss and a causal connection between a breach and a loss. The court explained, "[i]n *DePerno*, plaintiffs clearly established both a breach and loss to the fund . . . before the burden shifted to defendants." *Id.* at *11.

12. In *United States Life Insurance Co. v. Mechanics & Farmers Bank*, 685 F.2d 887, 896 (4th Cir. 1982), the court rejected plaintiff's

(Cont'd)

None of the rationales for shifting the burden applies to Petitioner's claims against Principal. Rather, to shift the burden in an action for breach of co-fiduciary obligations under the facts presented here would make investment managers, such as Principal, virtual insurers of the misdeeds of the named fiduciaries and trustees of a plan. Investment managers would be presumptively liable for the entire amount of a plan's loss simply by learning of an earlier breach that caused the loss. The investment manager would be presumptively liable even if, as here, it had no role in causing the loss. Imposition of such broad ranging liability for breach of co-fiduciary obligations finds no support in the law and would serve only to burden beneficiaries with additional fees that investment managers would be forced to charge to cover their risk of being held liable for losses caused by other fiduciaries and over which they had no control.

(Cont'd)

> novel proposition that, whenever a breach of the obligation by a trustee has been proved, the burden shifts to the trustee to establish that any loss suffered by the beneficiaries of the trust was not proximately due to the default of the trustee, and that, unless the trustee meets this burden, recovery against the trustee for the full loss follows in course.

Reaching this conclusion, the court distinguished cases which shifted the burden on the grounds that they involved "the 'rule of trust pursuit' or the situation where a trustee has converted trust property and commingled the proceeds with his own funds." *Id.* In this situation, if "the beneficiaries are prevented from separating their assets from the 'entire mass' in which their assets are commingled," equity will place the burden of proving what portion of the assets do not belong to the trust on the breaching trustee. *Id.*

CONCLUSION

For the reasons stated, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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APPENDIX

APPENDIX A — RELEVANT STATUTES INVOLVED

29 U.S.C. § 1105. Liability for breach by co-fiduciary

(a) Circumstances giving rise to liability

In addition to any liability which he may have under any other provisions of this part, a fiduciary with respect to a plan shall be liable for a breach of fiduciary responsibility of another fiduciary with respect to the same plan in the following circumstances:

(1) if he participates knowingly in, or knowingly undertakes to conceal, an act or omission of such other fiduciary, knowing such act or omission is a breach;

(2) if, by his failure to comply with section 1104(a)(1) of this title in the administration of his specific responsibilities which give rise to his status as a fiduciary, he has enabled such other fiduciary to commit a breach; or

(3) if he has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach.

Appendix A

29 U.S.C. § 1109. Liability for breach of fiduciary duty

(a) Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this subchapter shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary. A fiduciary may also be removed for a violation of section 1111 of this title.

(b) No fiduciary shall be liable with respect to a breach of fiduciary duty under this subchapter if such breach was committed before he became a fiduciary or after he ceased to be a fiduciary.

29 U.S.C. § 1132. Civil enforcement

(a) Persons empowered to bring a civil action.

A civil action may be brought —

(1) by a participant or beneficiary —

(A) for the relief provided for in subsection (c) of this section, or

(B) to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan;

(2) by the Secretary, or by a participant, beneficiary or fiduciary for appropriate relief under section 1109 of this title;

(3) by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this subchapter or the terms of the plan;

(4) by the Secretary, or by a participant, or beneficiary for appropriate relief in the case of a violation of 1025(c) of this title;

(5) except as otherwise provided in subsection (b) of this section, by the Secretary (A) to enjoin any act or practice which violates any provision of this subchapter, or (B) to obtain other appropriate equitable relief (i) to redress such violation or (ii) to enforce any provision of this subchapter;

(6) by the Secretary to collect any civil penalty under paragraph (2), (4), (5), or (6) of subsection (c) or under subsection (i) or (*l*);

(7) by a State to enforce compliance with a qualified medical child support order (as defined in section 1169(a)(2)(A) of this title);

(8) by the Secretary, or by an employer or other person referred to in section 1021(f)(1) of this title, (A) to enjoin any act or practice which violates subsection (f) of section 1021 of this title, or (B) to obtain appropriate equitable relief (i) to redress such violation or (ii) to enforce such subsection; or

(9) in the event that the purchase of an insurance contract or insurance annuity in connection with termination of an individual's status as a participant covered under a pension plan

with respect to all or any portion of the participant's pension benefit under such plan constitutes a violation of part 4 of this title[1] or the terms of the plan, by the Secretary, by any individual who was a participant or beneficiary at the time of the alleged violation, or by a fiduciary, to obtain appropriate relief, including the posting of security if necessary, to assure receipt by the participant or beneficiary of the amounts provided or to be provided by such insurance contract or annuity, plus reasonable prejudgment interest on such amounts.

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1. So in original. Probably should be "subtitle".